

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
BRIEF**

75-4197

No. 75-4197

No. 75-4198

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

FRED A. BERZON and GERTRUDE BERZON, Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE, Appellee.

ON APPEAL FROM DECISIONS OF THE UNITED STATES TAX COURT

BRIEF FOR APPELLANTS

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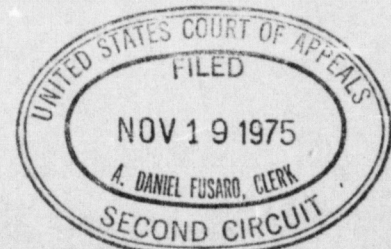




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BRIEF FOR APPELLANTS

PRELIMINARY STATEMENT

This is an appeal from the decisions of the United States Tax Court, per Sterrett, J., officially reported sub nom. Fred A. Berzon, 63 T.C. 601 (1975).

STATEMENT OF ISSUE PRESENTED FOR REVIEW

Whether the Tax Court erred in holding that appellants were not entitled to claim annual exclusions from Federal gift tax allowed by section 2503 of the Internal

Revenue Code of 1954 because the value of income interests in trusts created by Fred A. Berzon could not be ascertained?

STATEMENT OF THE CASE

This appeal involves the action by Fred A. Berzon and Gertrude Berzon, husband and wife, to determine that deficiencies in Federal gift taxes alleged by the Commissioner of Internal Revenue are erroneous. The Commissioner asserted that there were deficiencies of \$20,189.55 in the Federal gift taxes of Fred A. Berzon and \$20,189.55 in the Federal gift taxes of Gertrude Berzon, plus interest as allowed by law.

Fred A. Berzon and Gertrude Berzon commenced this action by filing separate petitions in the United States Tax Court on December 27, 1971. (R. 3, 6) */. Trial was held in New York, New York, before the Honorable Samuel B. Sterrett on December 12, 1973. (R. 12) Pursuant to the parties' joint oral motion, the cases were consolidated for

*/ "R." references are to pages of the Record on Appeal, portions of which will be reproduced in a separately bound appendix in accordance with Rule 30(c) of the Federal Rules of Appellate Procedure.

purposes of trial, briefs, and opinion. (Tr. 6) On March 11, 1975, Judge Sterrett, in findings of fact and an opinion reviewed by the full Tax Court, ordered decisions to be entered under Rule 155 of the Court's Rules of Practice and Procedure. 63 T.C. 601 (1975) Decisions, based on the parties' agreed computations, were entered on June 11, 1975, determining that there were deficiencies of \$19,276.05, plus statutory interest, in the Federal gift taxes of each taxpayer. (R. 15). On August 22, 1975, timely notices of appeal by the taxpayers to this Court were filed. (R. 23). Jurisdiction of this Court is founded on section 7482 of the Internal Revenue Code of 1954.

Based upon the written stipulation of the parties (Stip.), the oral testimony adduced at trial (Tr.), and the exhibits introduced into evidence (Exh.), the facts of this case are summarized as follows:

Fred A. Berzon and Gertrude Berzon are husband and wife residing in Purchase, New York. (Stip. 1, R. 11) Each taxpayer filed separate United States Gift Tax Returns for the calendar years 1965, 1966, 1967, and 1968, with the District Director of Internal Revenue for Manhattan, at New York, New York. (Stip. 4, 5) These returns reported trans-

fers of the capital stock of The Simons Co., Inc., by Fred A. Berzon to trusts created for the benefit of his children and grandchildren. (Exh. 3-C through 13-M, 16-P through 18-R) Gertrude Berzon consented, in accordance with section 2513 of the Internal Revenue Code of 1954 ("the Code"), to have the gifts made by her husband treated as having been made one-half by her.

Fred A. Berzon created eight separate trusts, one for each of his two adult children and his six minor grandchildren, pursuant to two Trust Agreements dated December 28, 1962, and January 5, 1965, respectively. (Stip. 3, 6; Exh. 2-B) The terms of the trusts are in all material respects identical, differing only in the designation of the beneficiary of each trust. The trust instruments provide for the accumulation of net income during the minority of a beneficiary, but authorize the trustees to apply the accumulated income in their discretion for the support and maintenance of the minor, and direct the trustees to distribute all remaining accumulated income to the beneficiary upon his attaining the age of 21. For an adult beneficiary, net income is distributable in quarterly installments. The corpus of each trust, other than stock in The

Simons Co., Inc., is distributable to its beneficiary when he attains his majority; the remaining corpus is distributable and the trust terminates upon (a) redemption of The Simons Co., Inc., stock by the corporation, (b) 20 years from the date of execution of the trust instrument, or (c) the death of the beneficiary, whichever first occurs. The trust agreements authorize the trustees to sell or otherwise dispose of the trust property or to retain the trust property in the form originally received, as they deem advisable. The trusts were made in and are governed by the laws of the State of New York.

Between 1962 and 1968, Fred A. Berzon made annual gifts totalling 720 shares of The Simons Co., Inc., stock to the above-described trusts. (Stip. 6; Exh. 14-H)

The Simons Co., Inc., is a closely held corporation controlled by Fred A. Berzon. (Stip. 7; Exh. 14-H, 15-0; Tr. 10, 15) The stock of the corporation was subject to a Stockholders Agreement dated September 20, 1962, which inter alia grants rights of first refusal to purchase the stock offered by stockholders to members of the Berzon family, and permits transfer of The Simons Co., Inc., stock by the trustees only with the consent of other stockholders.

(Stip. 2; Exh. 1-A) The Stockholders Agreement obligates the corporation to repurchase the stock owned by the trusts within ten years from the date thereof, and to pay for that stock, with interest, within twenty years from the date of the agreement.

Pursuant to the above agreement, the value of such stock was determined annually by the stockholders. (Exh. 1-A) Such values were reported in the Federal gift tax returns filed by the taxpayers for the years 1962-1968. (Tr. 14)

No dividends were declared by The Simons Co., Inc., on its capital stock from 1962 through 1968. (Tr. 11, 13)

The Tax Court determined the fair market value of The Simons Co., Inc., stock to be as follows: (63 T.C. at 614)

<u>Date of Gift</u>	<u>Value Per Share of The Simons Co., Inc., Stock</u>
Jan. 5, 1965	\$444
Jan. 4, 1966	500
Jan. 4, 1967	560
Jan. 4, 1968	642

The court also held that the beneficiaries' interests in the corpus of the eight trusts constituted future interests in property and that their interests in the income of the

trusts, although assumed to be present interests, were not reasonably susceptible of valuation. (63 T.C. at 615-618) The court therefore sustained the Commissioner's disallowance of the eight annual exclusions claimed by each taxpayer for 1965-1968, and the increase in each taxpayer's aggregate taxable gifts by reason of disallowance of five annual exclusions for 1962-1964. (63 T.C. at 620) Decisions were entered in accordance with the Tax Court's opinion and this appeal follows.

SUMMARY OF ARGUMENT

In 1962 and 1965, Fred A. Berzon created trusts which provided income interests for the benefit of his children and grandchildren. Annually, from 1962 through 1968, he transferred stock in The Simons Co., Inc. to these trusts. Mr. Berzon and his wife Gertrude (who consented to have these transfers treated as made one-half by her) filed Federal gift tax returns reporting these transfers as gifts of "present interests" in property. The Commissioner of Internal Revenue not only challenged the reported value of The Simons Co., Inc., stock but also disal-

lowed the annual exclusions on the grounds that all interests in the trusts were "future interests."

The Tax Court, per Sterrett, J., determined the fair market value of The Simons Co., Inc., stock at the dates of transfer, a determination which neither the Commissioner nor the taxpayers now contest. The trial court also assumed, but did not decide, that the income interests in the Berzon trusts were "present interests" within the meaning of section 2503 of the Code. Nevertheless it denied the annual exclusions claimed by the taxpayers on the grounds that the value of the beneficiaries' income interests in the trusts could not be ascertained.

In this brief, we respectfully submit that the Tax Court erred in deciding that the value of the income interests could not be determined. In accordance with the gift tax regulations, the value of an income interest in a trust for a term of years concurrent with one or more lives is determinable by reference to standard actuarial tables. While the values thus produced may not be precise in a particular case, use of the tables is justified and has been approved by this Court. Gelb v. Commissioner, 298 F.2d 541 (2d Cir. 1962).

Second, use of the actuarial tables is not conditioned on proof by the taxpayer that the donee of an interest in trust income is certain to obtain beneficial enjoyment. Such certainty is required only in the case of gifts of income interests to charitable organizations, and then only to claim a charitable deduction for Federal income, estate, or gift tax purposes. See, e.g., Elise McK. Morgan, 42 T.C. 1080 (1964), aff'd. 353 F.2d 209 (4th Cir. 1965). Extending the requirement of certainty of beneficial enjoyment as a condition for the valuation of taxable gifts is erroneous and has been rejected by this Court. Commissioner v. Marshall, 125 F.2d 943 (2d Cir. 1942).

Third, the fact that the taxpayer donated stock in a closely held corporation which he controlled is not a material consideration in determining the value of a right to trust income. The "property" being valued is an income interest, not the right to dividends from specific shares. Rosen v. Commissioner, 397 F.2d 245 (4th Cir. 1968) rev'g. 48 T.C. 834 (1967); Carl E. Weller 38 T.C. 790 (1962). Fred A. Berzon's ownership of a majority of the stock of The Simons Co., Inc., did not give him a right or the de facto power to control or alter the income interests in question. United States v. Byrum, 408 U.S. 125 (1972).

In summary, the mere inability to predict the amount of trust income which the beneficiaries of the Berzon trusts were unconditionally entitled to enjoy does not convert a present interest into a future interest. The requirement that a present interest have an "ascertainable value" adds nothing to the criteria for present interests established by the Supreme Court in Commissioner v. Diss-ton, 325 U.S. 442 (1945). Since the income interests in issue satisfy those criteria, the Tax Court erred in denying annual exclusions therefor.

A R G U M E N T

THE TAX COURT ERRED IN DECIDING THAT THE VALUE OF AN UNCONDITIONAL INTEREST IN TRUST INCOME IS NOT REASONABLY SUSCEPTIBLE OF VALUATION.

- A. Under the Applicable Gift Tax Regulations, the Value of an Interest in Trust Income for a Term of Years Concurrent with a Life is Determined by Reference to Standard Actuarial Tables.

Fred A. Berzon established trusts for the benefit of his children and grandchildren to which he made yearly gifts of stock in The Simons Co., Inc. In determining

whether those gifts qualify for the \$3,000 annual exclusion allowed by section 2503 of the Code, the Tax Court comminuted the transfers into three separate components and tested whether each element constituted a gift of a "present interest" under the statute. Fondren v. Commissioner, 324 U.S. 18 (1945); Commissioner v. Disston, 325 U.S. 442 (1945).

The three separate gifts were (1) an interest in trust corpus, limited to take effect up to 20 years after the trusts were created; */ (2), in the case of Mr. Berzon's adult children, an interest in trust income payable quarterly for a maximum term of 20 years or until the prior death of the beneficiary; and (3), in the case of his minor grandchildren, an interest in trust income which could be accumulated by the trustees until the beneficiary attained the age of 21 or died, provided that the accumulated income was paid to the beneficiary or his estate.

The Tax Court reasoned that one separate and distinct item of "property" given to the Berzon children and grandchildren was the right to receive trust income, measured by a term of years concurrent with the beneficiary's

*/ Taxpayers do not contest the Tax Court's opinion that the donee's interest in trust corpus was a future interest.

life. Carl E. Weller, 38 T.C. 790 (1962). This property, considered separately, can qualify as a present interest under section 2503(b) or, in the case of minors, section 2503(c). Arlean I. Herr, 35 T.C. 732 (1961), aff'd. 303 F.2d 780 (3d Cir. 1962); Estate of Levine, 63 T.C. 136 (1974); cf., Rev. Rul. 69-344, 1969-1 C.B. 225. The court, however, denied the \$3,000 annual exclusion, not because the income interests were future interests, but because the values of such interests could not be ascertained. 63 T.C. at 618.

Section 2512(a) of the Code provides that if a "gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift." The statute does not prescribe methods for ascertaining the value of property; the matter is left to the Treasury's gift tax regulations. Section 25.2512-5 */ of those regulations deals specifically with the determination of values

*/ The cited regulation applies only to gifts made prior to January 1, 1971; Treas. Regs. §25.2512-9 applies to transfers completed after December 31, 1970. The latter regulations contain substantial revisions in assumptions underlying the actuarial tables, including at six percent interest rate and recognition of the differing life expectancies of males and females.

of annuities, life estates, terms for years, remainders, and reversions, stating without qualification that "the fair market value of *** terms for years *** is their present value determined under this section." Treas. Regs. section 25.2512-5(c)(1). Where, as here, the property to be valued is "a term certain concurrent with one or more lives," paragraph (e) of section 25.2512-5 provides that "a special factor is necessary. The factor is to be computed upon the basis of the Makehamized mortality tables appearing as Table 38 of the United States Life Table and Actuarial Tables, 1939-1941, published by the United States Department of Commerce, Bureau of the Census, and interest at the rate of 3-1/2 percent a year, compounded annually." If factors are determined in accordance with the Internal Revenue Service's pamphlet "Actuarial Values for Estate and Gift Tax," a value for each income interest in the trusts created by Fred A. Berzon can be definitively ascertained.

The Tax Court held, however, that "employment of the actuarial tables *** may not be had to value such income interests since their use would produce a clearly erroneous valuation." 63 T.C. at 618. For 1965-1968, these

tables were based on an assumed yield of 3-1/2 percent per annum. In fact, the Berzon trusts realized no income during the years in issue, so that the computed value of the income interest is necessarily inaccurate.

We respectfully submit that the Tax Court erred because an inaccurate result in a particular case is not grounds to depart from the regulations. Since the problem of valuing income and remainder interests is "at best a highly speculative undertaking" or "a matter of educated guesswork," the courts cannot and do not "demand perfection in an area so fraught with speculation and uncertainty." McMurtry v. Commissioner, 203 F.2d 659, 666 (1st Cir. 1953); Hipp v. United States, 215 F.Supp. 222, 226 (W.D.S.C. 1962). While the Treasury's tables "seldom accurately predict the value in a particular situation [they] prove to be accurate when used in a great number of instances." Hipp v. United States, supra at 226. The use of these tables is justified, not by their accuracy or certainty in valuing particular income interests, but as this Court stated in Gelb v. Commissioner, 298 F.2d 544, 552 (2d Cir. 1962), by the fact that "the United States is in

business with enough different taxpayers so that the law of averages has ample opportunity to work." */ The probability that an income interest is overvalued in one case is offset by the likelihood that a similar interest will be undervalued in another. "Such discrepancies as may exist will no doubt average out in the long run; and while this may sometimes prove to be unfortunate for individual taxpayers, the discrepancies may have to be suffered in the interest of a simplified overall administration of the tax laws." McMurtry v. Commissioner, supra at 667.

If the law of averages is to work, a fortiori there must be particular cases in which use of the tables also proves unfortunate for the Internal Revenue Service. But, in all events, the fact that the tables' assumed 3-1/2 percent yield is, at the date of valuation, greater (or less) than actual yields -- thereby producing a "clearly erroneous result" in a particular case -- is not grounds to disregard the tables.

*/ The Court's opinion in Gelb v. Commissioner, supra, was cited and quoted with approval by the Supreme Court in Northeastern Pennsylvania National Bank & Trust Company v. United States, 387 U.S. 213, 224 (1967).

B. Use of Actuarial Tables to Value an Income Interest does not Require Certainty that Income will be Enjoyed.

Implicit in the Tax Court's decision in this case and in Leonard Rosen, 48 T.C. 834 (1967) rev'd. 397 F.2d 245 (4th Cir. 1968), is a requirement that, to use actuarial tables whenever trust corpus consists of stock in a closely held corporation, the taxpayer must establish that the stock will pay dividends so that the trust yields income for the beneficiary to enjoy. See Elise McK. Morgan, 42 T.C. 1080 (1964), aff'd 353 F.2d 209 (4th Cir. 1965); Hamm v. Commissioner, 325 F.2d 934 (8th Cir. 1963); Stark v. United States, 477 F.2d 131 (8th Cir. 1973), cert. denied 414 U.S. 975 (1973), aff'g. per curiam, 345 F.Supp. 1263 (W.D. Mo. 1972),; cf., also, Van Den Wymelenberg v. United States, 397 F.2d 443 (7th Cir. 1968), cert. denied 393 U.S. 953 (1968), aff'g. 272 F.Supp. 571 (E.D. Wis. 1967); Fischer v. Commissioner, 288 F.2d 574 (3d Cir. 1961).

The above requirement is of dubious origin and less merit. Vogel v. United States, 42 F.Supp. 103 (D. Mass. 1941), appears to be the first case to require that the value of a present interest be determined "with practical certainty" in order to qualify for the present interest exclusion. This requirement is expressly derived from the Supreme Court's decision in Humes v. United States, 276 U.S. 487 (1927), involving the disallowance of an estate tax charitable deduction for a contingent charitable remainder interest. More to the point, the same principle was applied by the Tax Court in Elise McK. Morgan, supra, to deny charitable deductions for charitable income interests, where trust corpus consisted of stock in a closely held corporation, on the grounds that the value of the charitable interest could not be ascertained. A similar result obtained in Hamm v. Commissioner, supra.

In these cases, the issue was not the ascertainability of values, but the certainty of beneficial enjoyment, which is an express condition to the allowance of a

charitable deduction for income, gift, and estate tax purposes. */ In Morgan, the donors established a trust to which they transferred nonvoting common stock in a closely held corporation. The trust instrument provided for the payment of income for a charitable purpose for 20 years, remainder to the donor's heirs. The court disallowed income and gift tax deductions for the value of the charitable income interest because there was no certainty of beneficial enjoyment by the charity: "dividends on common stock had been declared in only 2 of the last 11 years; the donors controlled the corporation; the trustees and remain-

*/ For gifts made prior to the effective date of the Tax Reform Act of 1969, Treas. Regs. §1.170-1(e) provides that a charitable income tax deduction "is not allowed in the case of a transfer in trust conveying a present interest in income if by reason of all the conditions and circumstances surrounding the transfer it appears that the charity may not receive the beneficial enjoyment of the interest. For example, assume that assets placed in trust consist of stock in a corporation the fiscal policies of which are controlled by the donor and his family, that the trustees and remaindermen are likewise members of the donor's family, and that the governing instrument contains no adequate guarantee of the requisite income to the charitable organization. Under such circumstances, no deduction will be allowed." (Emphasis added) The estate tax regulations, §20.2055-2(b), and the gift tax regulations, §25.2522(a)-2(b), contain substantially identical requirements for certainty of beneficial enjoyment as a condition to the allowance of charitable deductions for pre-1969 transfers to "split-interest" trusts.

dermen were members of the donors' family; and the trust instrument contained no provisions guaranteeing income to the charity. The donors can at any time deny benefits to the charity by refraining from declaring dividends." 42 T.C. at 1087. To qualify for the charitable deduction, there must be more than an estimate of "value;" there must be some assurance that the charitable donee will receive beneficial enjoyment. Thus, in Morgan and Hamm, proof of a probable dividend yield was required to establish the likelihood of actual enjoyment, not to prove the "value" of the income interest.

Unfortunately, however, a number of the cases relied on by the Tax Court in this case and Rosen appear to confuse these two distinct concepts. In Fischer v. Commissioner, supra, the taxpayer transferred improved real estate as a gift in trust for the benefit of his three adult daughters. During the 15-year term of the trust, net income was payable in equal quarterly installments to each daughter or, if she died, to her issue. The Internal Revenue Service conceded that the daughters' income interests were present interests, but denied annual exclusions on the grounds that their value "cannot be determined with reason-

able certainty." Although the taxpayer established annual income of \$80,100 and operating expenses of \$50,000, "leaving a balance of \$30,100, ample to justify the \$9000 exclusion three times," the Court of Appeals determined that the amount of "net income" distributable to each beneficiary could not be accurately predicted. 288 F.2d at 577. Trust "net income" (viz., cash flow) depended not only on the rents derived from the property and the operating expenses incurred (neither of which was immutable), but also on the principal amount of mortgage indebtedness amortized, repairs and capital improvements made, and the possibility that the trustee could incur and pay encumbrances on additions to trust property. "Under such circumstances," which are found in the case of every trust which is invested in real estate or other equities, "the present interests could not be valued with reasonable certainty." 288 F.2d at 578.

Similarly, in Van Den Wymelenberg v. United States, supra, present interest exclusions were denied because the trustees' powers of sale and investment "could significantly affect the income from the trust." 397 F.2d at 446. Since the trustees "could exchange the trust property for high or low income yielding assets" and "could

reduce the net income by allocating receipts to principal and/or apportioning expenditures to income," the income beneficiary was not certain to enjoy any benefits from the trust. Id. Therefore, notwithstanding the fact that virtually all trustees have these powers (whether under the governing instrument or by state law), the value of the present interests in trust income was held to be unascertainable. */

Most recently, in Stark v. United States, supra, the court simply repeated the holdings of the Morgan, Fischer, and Van Den Wymelenberg cases as a shibboleth, equating the certainty of beneficial enjoyment with the ascertainability of value. The court construed these cases to require the taxpayer to establish definitively that in all

*/ But see Frances Carroll Brown, 30 T.C. 831 (1958), where it was held that even an "absolute discretion" in the trustee to affect the amount of distributable income will not be deemed to render the value of a present income interest indeterminable where the trustee's powers were intended solely to facilitate administration of the trust. See, also, Mercantile - Safe Deposit and Trust Co., Ex'rs. v. U.S., 311 F.Supp. 670 (D. Md. 1970); James T. Pettus, Jr., 54 T.C. 112 (1970). These cases limit the holdings of Fischer and Van Den Wymelenberg to situations in which the trust instruments confer excessive administrative powers upon the trustees, apparently making the beneficiaries' rights to receive income contingent rather than absolute. The annual exclusions are thus denied, not because values are unascertainable, but because the income interests are not present interests. See pp. 33-34, infra.

events the donee will receive a fixed or determinable income flow, unaffected by normal investment risks and vicissitudes or the power of trustees to alter or adjust investment yields. Otherwise the income interest will have no ascertainable value. This requirement is tantamount to a demand that the beneficiary receive a guaranteed annuity, regardless of the actual investment experience of trust assets, since only through an annuity is the beneficiary's enjoyment assured with "reasonable certainty." */

*/ Guaranteed annuities and required "unitrusts" were the legislative solution to the problem of allowing charitable deduction for interests in trust income given to charitable organizations. Tax Reform Act of 1969, P.L. 91-172, §201. In 1969, the Treasury found that "Under present law, the amount of the allowable [charitable] deduction would be determined on the assumption that the trust will earn 3-1/2 percent per year which will be paid to charity and that the present value of such periodic payments may be determined by discounting the anticipated payments at 3-1/2 percent. In fact, however, the trustee may invest the property in the common stock of corporations pursuing a policy of retaining earnings rather than distributing dividends so that the periodic payments to the charity are far less than the 3-1/2 percent return assumed." U.S. Treas. Dept., Tax Reform Studies and Proposals, Pt. 2 p. 190 (1969). Finding the administrative and judicial requirements for certainty of beneficial enjoyment an inadequate safeguard, Congress amended §§170, 2055, and 2522 to provide that, to be deductible, the charitable interest in the trust take the form of a guaranteed annuity or unitrust. §§170(f)(2)(B), 2055(e)(2)(B), and 2522(c)(2)(B). See, generally, Lovell, "The Unitrust: A New Concept to Meet an Old Problem," 105 Trusts and Estates 215 (1966). Although the above-identified problem is also present in noncharitable trusts, Congress took no action to impose similar requirements for the allowance of present interest exclusions. See H. Rept. No. 91-413 (pt. 1), 91st Cong., 1st Sess. 60-62 (1969); Sen. Rept. No. 91-552, 91st Cong., 1st Sess. 91-93 (1969).

But, as this Court held in Commissioner v. Marshall, 125 F.2d 943 (2d Cir. 1942), the concept of "value" is wholly independent of the certainty of beneficial enjoyment. In Judge Frank's words, "Anyone who wants to eliminate uncertainties from 'value' will have a sad time getting along in this world. **** We cannot, by use of a symbol, 'value,' convert the risky into risklessness, Canute restless change out of existence." 125 F.2d at 946. Thus, to require (as the Tax Court does in this case and in Leonard Rosen) that stock pay dividends in order that an income interest have "value,"

"****would preclude a tax on any 'value' which is not almost certain to correspond with actual enjoyment. But 'value' seldom does so correspond. The fallacy in that argument stems largely from lack of recognition of the eely character of the word 'value.' **** [A]s almost always, 'value' involves a conjecture, a guess, a prediction, a prophecy. **** '[Value] depends largely on more or less certain prophecies of the future; and the value is no less real *** if later the prophecy turns out to be false than when it comes out true.' Ithaca Trust Co. v. United States, 279 U.S. 151, 155. **** It is immaterial that actuarial estimates may not accord with realities." Id. (Emphasis added)

Thus, under Marshall, it is not material in determining the value of the Berzon children's and grandchildren's income interests whether or not The Simons Co.,

Inc., paid dividends. This is only one of a number of imprecise and unpredictable factors that may affect whether, and the extent to which, the donees may actually realize beneficial enjoyment of their income interests. These virtually innumerable factors -- decisions of the trustees to sell, or of the corporation or others to buy, the stock; the death of a shareholder precluding dividends for three years; the increase or decrease in corporate earnings based on changes in technology or women's tastes and fashion; the imposition of an accumulated earnings tax; the particular demands of stockholders for funds -- can have no bearing on the necessary task of ascertaining values for gift tax purposes, a process which must ignore imponderables in order to produce a definitive, albeit somewhat arbitrary, result. Otherwise, it would be almost impossible to impose a gift tax on (or to exclude from gift tax) virtually any item of property not immediately consumed and enjoyed. */

*/ For example, if a donor transferred stock in a closely held corporation to a trust to pay income to his child for 10 years, reversion to the donor, the existence or nonexistence of a taxable (or excludable) gift would appear to depend, in the Tax Court's view, on whether the donee was likely to realize beneficial enjoyment of the income interest, which in turn would depend on the likelihood of dividends, etc. The difficulties of such predictions would threaten the integrity of the entire gift tax system.

C. That The Simons Co., Inc., is a Closely Held Corporation Controlled by the Donor is Immaterial In Valuing Interests in Trust Income.

Because The Simons Co., Inc., was closely held, controlled by the donor, and had never paid a dividend, the Tax Court held that the expectation that dividends would be paid in the future was, notwithstanding the controlling stockholder's testimony to the contrary, too speculative to be valued. We respectfully submit that the court erred because the property to be valued was not the right to dividends on The Simons Co., Inc., stock but the right to income from the trusts. Carl E. Weller, 38 T.C. 790 (1962). Since the trustees could (indeed, under the Stockholders Agreement, expected to) dispose of the stock and were empowered to reinvest trust assets, facts pertaining to ownership and control of the corporation and the probability of dividends being declared are largely irrelevant to the issue at hand. */ Rosen v. Commissioner, 397 F.2d 345, 347 (4th Cir. 1968).

*/ The fact that The Simons Co., Inc., did not regularly pay dividends may have been considered by the Tax Court in determining the value of the donated stock. Since the value of the stock is one factor taken into account in computing the actuarial values of income interests, the lower value resulting from the nonincome-producing character of the property is indirectly reflected in the value of the income interests. We respectfully submit that, under Treas. Regs. §25.2512(a)-5(e), no further reduction in value is authorized.

If, indeed, the Tax Court's decision in Berzon is predicated on the fact that The Simons Co., Inc., is closely held and controlled by the donor, the issue here is a variation of the one raised in United States v. Byrum, 408 U.S. 125 (1972). In that case, a donor transferred stock in three closely held corporations to an inter vivos trust for the benefit of his children. Because he retained, among other powers, the right to vote the donated stock, the donor held voting control of 71 percent of each corporation's stock. Following the donor's death, the Internal Revenue Service included the value of the donated stock in his gross estate under section 2036(a) of the Code because the decedent had the right to control beneficial enjoyment of trust property and income. The Government's argument was summarized by Mr. Justice Powell as follows:

"By retaining voting control over the corporations whose stock was transferred, Byrum was in a position to select the corporate directors. **** These rights, it is said, gave him control over corporate dividend policy. By increasing, decreasing, or stopping dividends completely, it is argued that Byrum could 'regulate the flow of income to the trust' and thereby shift or defer the beneficial enjoyment of trust income of trust income between the present beneficiaries and the remaindermen. The sum of this retained power is said to be tantamount to a grantor-trustee's power to accumulate income in the trust, ***." 408 U.S. at 132.

In this case, the Government's argument is, in substance, the same. Because Mr. Berzon was the controlling stockholder of The Simons Co., Inc., it is assumed that he could (through the control of the board of directors) start, stop, increase, or decrease the payment of dividends on the stock held by the trusts. By exercising such control, Mr. Berzon could thus shift beneficial enjoyment between the present-interest element and the future-interest element in trust property. Accordingly, it may be argued, the present rights of the income beneficiaries are not fixed, but are subject to the discretion of the donor-controlling shareholder, and thus do not qualify as present interests. See Fondren v. Commissioner, 324 U.S. 18 (1945).

The Supreme Court's response to this argument in the Byrum case is apposite here. The Court recognized that a controlling shareholder, particularly where (as here) there are independent minority interests involved, does not have unfettered discretion to pay or withhold, increase or decrease, dividends. The discretion of boards of directors and controlling shareholders is inhibited by a myriad of legal and economic considerations. As recited by the

Court, these constraints include: (1) "the customary vicissitudes of such enterprises *** [which] prevent any certainty or predictability as to earnings or dividends" (408 U.S. at 139); (2) the need to "balance the expectation of stockholders to reasonable dividends when earned against corporate needs for retention of earnings" (408 U.S. at 140); (3) when earnings are substantial, the potential imposition of an accumulated earnings tax (408 U.S. at 141); (4) the directors' and majority stockholder's enforceable fiduciary obligations to minority stockholders (408 U.S. at 141-142). In light of these considerations, the Court concluded "that Byrum did not have an unconstrained de facto power to regulate the flow of dividends to the trust, much less the 'right' to designate who was to enjoy the income from trust property." 408 U.S. at 143.

The legal and economic constraints at work in the Byrum case operated with equal force here. For precisely the reasons identified by the Supreme Court, Mr. Berzon did not have unfettered discretion over the payment of dividends by The Simons Co., Inc. */ He could not control

*/ Fred A. Berzon testified as follows regarding the payment of dividends by The Simons Co., Inc.:

[cont'd. next page]

whether or not the corporation would realize profits or losses. He and the other directors had to balance the corporation's need for funds to finance internal expansion

*/ [cont'd. from prior page]

"Well, I made [the gifts] because you told me that we had a surplus of about a half million dollars and that we better start declaring some dividends; and that I didn't need the money, and I thought -- I was thinking in direction of college and of subsequent benefits that the children would get. There was -- with that kind of a surplus, I felt we would certainly pay some dividends. That's what I did." (Tr. 10)

"Q. Now, this was on December 28, 1962. Now, the record shows that in 1963 and '64, you didn't pay any dividends. Was there any particular reason why the company didn't pay a dividend after you set up this trust with the intent of paying one? Why didn't you pay one?"

"A. Oh, our principal competitor, Lewis, came to me and wanted to sell out. He felt he was getting too old, although he was younger than I am, and we dickered and we finally bought that business; and it turned out to be a very good purchase.

"If we didn't have it -- well, we had surplus at that time, and then what we didn't have, we'd borrow. But it was a going business, and right off the bat, we did well with it, and we have it now, and it's a very important part of our business today. They handle the same stuff. We do it a little bit different anyway." (Tr. 11-12)

[cont'd. next page]

against the shareholder's needs for funds for consumption and reinvestment. If earnings were accumulated beyond reasonable business needs, Mr. Berzon could not prevent the Internal Revenue Service from imposing the penalty tax on those earnings. And Mr. Berzon could ignore only at his peril the wishes of his co-stockholders regarding the pay-

*/ [cont'd. from prior page]

"Q. Now tell me, subsequent to 1965, are there any major events that have occurred that have prevented you from paying dividends? Did you make any other substantial purchase, or go into any additional business?"

"A. I believe that's the time when we owned half of the building, and the people upstairs owned the other half, and they said, either you buy us out, or we buy you out. And we didn't want to give up that corner, and it looked -- we were right on the corner of 33rd and 5th, opposite the Empire State Building. It's a good building. So, we bought it. We paid 375,000 bucks for it.

"Well, after that, we went into the outlet hosiery stores in Pennsylvania. **** And we have 25 -- 24 of them, and we did that all in that short period of years, and it's wonderful. It's a concept they have in Pennsylvania. The outlets -- we call them outlet stores; and it didn't hurt the business we had established with other stores. And these things, they're just wonderful, the most fascinating thing I ever had in my life, as far as business is concerned. And it's working out fine." (Tr. 13-14)

ment of dividends. In sum, even though The Simons Co., Inc., was a closely held corporation controlled by Mr. Berzon, the payment or nonpayment of dividends, and therefore the trusts' realization of income and the relative values of the present and future interests therein, was not subject to his absolute control.

We do not argue that the trusts' realization of income was certain and predictable -- only that, qualitatively, the uncertainty involved was not materially different than the risks which accompany any investment in common stocks. The factors which affect decisions to pay or to withhold dividends by the boards of directors of publicly held corporations are essentially the same as those identified by the Supreme Court in the Byrum case, and the result is the same. Some public corporations pursue policies of regularly distributing earnings, others retain earnings to finance internal expansion and capital appreciation. For example, in a list of common stocks recommended for trust investment in 1968, */ six corporations yielded dividends

*/ See Haake, "Common Stocks for Trust Accounts," 107 Trusts and Estates 371 (1968). Underscoring the obvious uncertainties of prediction, the author of the cited article recommended the Penn Central Railroad as a trust investment in 1968. In light of hindsight, a return on that investment is, of course, far less predictable and uncertain than an investment in The Simons Co., Inc.

of one percent or less of their average market value in that year. */ Therefore, the fact that The Simons Co., Inc., was closely held and controlled by the donor has, we submit, no bearing on whether the value of the beneficiaries' present interests in the trusts were ascertainable.

D. There were No Conditions or Limitations on the Income Interests Making Employment of Actuarial Tables for Valuation Improper.

It must be emphasized that the Tax Court held only that the likelihood that the beneficiaries would enjoy income from the Berzon trusts was uncertain. Referring to the trustees' power to sell the donated shares and reinvest the proceeds in income-producing property, the court stated that the possibility of this occurring "is so uncertain as to be incapable of being valued." 63 T.C. at 619. Similarly, a minor beneficiary's right to realize and enjoy any appreciation in the value of trust corpus upon redemption of The Simons Co., Inc., stock was disregarded because "***

*/ Standard & Poor's Corporation, 42 Standard N.Y.S.E. Reports, 1210 (IBM); 1286K (Kaufmann and Broad); 1570T (NCR Corp.); 1861 (Polaroid Corp.); 1982 (Santa Fe International); 2208 (Texas Instruments) (1975).

it cannot be predicted whether the Simons Co. stock will appreciate in value or whether Simons Co. will then have a surplus enabling it to purchase and will then in fact purchase said stock." Id. "In other words," the court said, "it is not certain that the appreciation in value, if any, of the Simons Co. stock *** will necessarily be converted to cash and paid to a minor beneficiary upon his reaching age 21." 63 T.C. at 619-620.

"But if mere inability to forecast definitely the actual income from investments were the sole criterion of whether an interest is future, all present gifts of income accruing in the future could be classified as nothing other than future even though the right of enjoyment is immediate. Rents, dividends, indeed, practically all kinds of income are subject to lapse, change, and fluctuation. To constitute a future interest mere uncertainty of amount must be co-existent with restriction upon or postponement of immediate use and enjoyment." Commissioner v. Lowden, 131 F.2d 127, 128 (7th Cir. 1942) (emphasis added). Consequently, except perhaps for the Fischer and Van Den Wymel-enberg cases, supra, */ the only authorities which find

*/ See p. 21, supra.

that an income interest lacks "ascertainable value" involve instances in which the terms of the trust per se impede, limit, or condition the beneficiary's right to receive income. Rosen v. Commissioner, 397 F.2d 245, 247 (4th Cir. 1968).

The courts have therefore characterized as future interests of "unascertainable value" interests in trust income where there is a discretionary power in a person other than the donee to withhold, accumulate, or divert income, or to distribute income only in the case of need or other contingency, or to invade corpus for the benefit of others. Commissioner v. Disston, 325 U.S. 442 (1945); Funkhouser's Trusts v. Commissioner, 275 F.2d 245 (4th Cir. 1960); La-Fortune v. Commissioner, 263 F.2d 186 (10th Cir. 1958); Jacob W. Blasdel, 58 T.C. 1014 (1972); Andrew Geller, 9 T.C. 484 (1947) (semble). In all of these decisions the controlling issue was whether, as a matter of construction of the dispositive instrument, the donee's interest is "limited to commence in use, possession, or enjoyment at some future date or time," rather than whether, as a factual matter, it is possible to predict the income flow from

the underlying trust corpus. In the Disston case, for example, the Supreme Court decided an income interest was a future interest not because the trust corpus yielded little or no income, */ but because it was not possible to ascertain from the terms of the trust to what portion of the trust income the beneficiary was entitled. The latter is the essential characteristic of a future interest to which the added requirement of "ascertainable value" adds nothing.

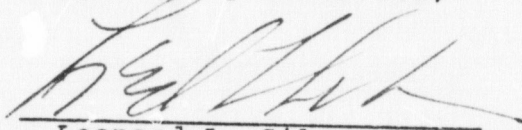
Here the donees of the Berzon trusts were named and determined. Each had an absolute and unconditional right to a specified share of trust income. Except insofar as permitted by section 2503(c) of the Code for minors, no discretion was reserved to the trustees or anyone else to withhold income or divert it to others. In short, there was no obstacle or impediment in the trust instruments which could prevent a beneficiary from receiving and enjoying his proportionate share of trust income.

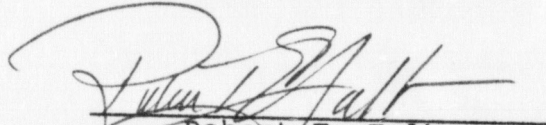
*/ In Disston one trust, which held unimproved realty, yielded no net income on corpus worth \$38,000, while a second trust earned less than \$1,500 on securities valued at more than \$70,000.

CONCLUSION

For the reasons set forth in this brief, we respectfully submit that the Tax Court erred in deciding that the value of unconditional interests in the income of the Berzon trusts could not be valued by reference to standard actuarial tables. We therefore urge this Court to reverse the decisions of the Tax Court herein and to remand the matter for further proceedings consistent with the allowance of annual exclusions from gift tax.

Respectfully submitted,


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ADDENDUM

INTERNAL REVENUE CODE OF 1954 (26 U.S.C.)

Sec. 2503. Taxable gifts.

(a) General Definition. -- The term "taxable gifts" means, in the case of gifts made after December 31, 1970, the total amount of gifts made during the calendar quarter, less the deductions provided in subchapter C (sec. 2521 and following). In the case of gifts made before January 1, 1971, such term means the total amount of gifts made during the calendar year, less the deductions provided in subchapter C.

(b) Exclusions From Gifts. -- In computing taxable gifts for the calendar quarter, in the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year 1971 and subsequent calendar years, \$3,000 of such gifts to such person less the aggregate of the amounts of such gifts to such person during all preceding calendar quarters of the calendar year shall not, for purposes of subsection (a), be included in the total amount of gifts made during such quarter. Where there has been a transfer to any person of a present interest in property, the possibility that such interest may be diminished by the exercise of a power shall be disregarded in applying this subsection, if no part of such interest will at any time pass to any other person.

(c) Transfer for the Benefit of Minor. -- No part of a gift to an individual who has not attained the age of 21 years on the date of such transfer shall be considered a gift of a future interest in property for purposes of subsection (b) if the property and the income therefrom --

(1) may be expended by, or for the benefit, of, the donee before his attaining the age of 21 years, and

(2) will to the extent not so expended --

(A) pass to the donee on his attaining the age of 21 years, and

(B) in the event the donee dies before attaining the age of 21 years, be payable to the estate of the donee or as he may appoint under a general power of appointment as defined in section 2514(c).

Sec. 2512. Valuation of gifts.

(a) If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

TREASURY REGULATIONS

Sec. 25.2503-2. Exclusions from gifts.

* * * *

(b) Gifts made before January 1, 1971. The first \$3,000 of gifts made to any one donee during the calendar year 1955, or 1970, or any calendar year intervening between calendar year 1955 and calendar year 1970, except gifts of future interests in property as defined in §§25.2503-3 and 25.2503-4, is excluded in determining the total amount of gifts for the calendar year. In the case of a gift in trust the beneficiary of the trust is the donee.

Sec. 25.2503-3. Future interests in property.

(a) No part of the value of a gift of a future interest may be excluded in determining the total amount of gifts made during the calendar quarter (calendar year in the case of gifts made before January 1, 1971). For the

definition of "calendar quarter" see §25.2502-1(c)(1). "Future interests" is a legal term, and includes reversions, remainders, and other interests or estates, whether vested or contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession or enjoyment at some future date or time. The term has no reference to such contractual rights as exist in a bond, note (though bearing no interest until maturity), or in a policy of life insurance, the obligations of which are to be discharged by payments in the future. But a future interest or interests in such contractual obligations may be created by the limitations contained in a trust or other instrument of transfer used in effecting a gift.

(b) An unrestricted right to the immediate use, possession, or enjoyment of property or the income from property (such as a life estate or term certain) is a present interest in property. An exclusion is allowable with respect to a gift of such an interest (but not in excess of the value of the interest). If a donee has received a present interest in property, the possibility that such interest may be diminished by the transfer of a greater interest in the same property to the donee through the exercise of a power is disregarded in computing the value of the present interest, to the extent that no part of such interest will at any time pass to any other person (see example (4) of paragraph (c) of this section). For an exception to the rule disallowing an exclusion for gifts of future interests in the case of certain gifts to minors, see §25.2503-4.

(c) The operation of this section may be illustrated by the following examples:

Example (1). Under the terms of a trust created by A the trustee is directed to pay the net income to B, so long as B shall live. The trustee is authorized in his discretion to withhold payments of income during any period he deems advisable and add such income to the trust corpus. Since B's right to receive the income payments is subject to the trustee's discretion, it is not a present interest and no exclusion is allowable with respect to the transfer in trust.

Example (2). C transfers certain insurance policies on his own life to a trust created for the benefit of D. Upon C's death the proceeds of the policies are to be invested and the net income therefrom paid to D during his lifetime. Since the income payments to D will not begin until after C's death the transfer in trust represents a gift of a future interest in property against which no exclusion is allowable.

Example (3). Under the terms of a trust created by E the net income is to be distributed to E's three children in such shares as the trustee, in his uncontrolled discretion, deems advisable. While the terms of the trust provide that all of the net income is to be distributed, the amount of income any one of the three beneficiaries will receive rests entirely within the trustee's discretion and cannot be presently ascertained. Accordingly, no exclusions are allowable with respect to the transfers to the trust.

Example (4). Under the terms of a trust the net income is to be paid to F for life, with the remainder payable to G on F's death. The trustee has the uncontrolled power to pay over the corpus to F at any time. Although F's present right to receive the income may be terminated, no other person has the right to such income interest. Accordingly, the power in the trustee is disregarded in determining the value of F's present interest. The power would not be disregarded to the extent that the trustee during F's life could distribute corpus to persons other than F.

Example (5). The corpus of a trust created by J consists of certain real property, subject to a mortgage. The terms of the trust provide that the net income from the property is to be used to pay the mortgage. After the mortgage is paid in full the net income is to be paid to K during his lifetime. Since K's right to receive the income payments will not begin until after the mortgage is paid in full the transfer in trust represents a gift of a future interest in property against which no exclusion is allowable.

Example (6). L pays premiums on a policy of insurance on his life. All the incidents of ownership in the policy (including the right to surrender the policy) are vested in M. The payment of premiums by L constitutes a gift of a present interest in property.

Sec. 25.2512-1. Valuation of property; in general.

Section 2512 provides that if a gift is made in property, its value at the date of the gift shall be considered the amount of the gift. The value of the property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts.

* * * *

Sec. 25.2512-5. Valuation of annuities, life estates, terms for years, remainders and reversions transferred on or before December 31, 1970. --

(a) In general.

(1) Except as otherwise provided in this subparagraph, the fair market value of annuities, life estates, terms for years, remainders, and reversions transferred on or before December 31, 1970, is their present value determined under this section. The fair market value of annuities, life estates, terms for years, remainders, and reversions transferred after December 31, 1970, is their present value determined under §25.2512-9. The value of annuities issued by companies regularly engaged in their sale and of insurance policies issued by companies regularly engaged in their sale is determined under §25.2512-6. Where the donor transfers property in trust or otherwise and retains an interest therein, the value of the gift is the value of the property transferred less the value of the donor's retained interest. If the donor assigns or relinquishes an annuity, life estate, remainder, or reversion which he holds by virtue of a transfer previously made by

himself or another, the value of the gift is the value of the interest transferred. See §25.2512-9(a)(1)(ii) for application of this section to transfers in 1971 of certain interests in property created in December 1970.

(2) The present value of an annuity, life estate, remainder or reversion determined under this section which is dependent on the continuation or termination of the life of one person is computed by the use of Table I in paragraph (f) of this section. The present value of an annuity, term for years, remainder or reversion dependent on a term certain is computed by the use of Table II in paragraph (f). If the interest to be valued is dependent upon more than one life or there is a term certain concurrent with one or more lives, see paragraph (e) of this section. For purposes of the computations described in this section, the age of a person is to be taken as the age of that person at his nearest birthday.

(3) In all examples set forth in this section, the interest is assumed to have been transferred on or before December 31, 1970.

* * * *

(c) Life estates and terms for years. If the interest to be valued is the right of a person for his life, or for the life of another person, to receive the income of certain property or to use nonincome-producing property, the value of the interest is the value of the property multiplied by the figure in column 3 of Table I opposite the number of years nearest to the actual age of the measuring life. If the interest to be valued is the right to receive income of property or to use nonincome-producing property for a term of years, column 3 of Table II is used. The application of this paragraph may be illustrated by the following example:

Example. The donor, who during his life is entitled to receive the income from property worth \$50,000, makes a gift of such interest. The donor is 31 years old on the date of the gift. The value of the gift is \$35,534 ($\$50,000 \times .71068$).

* * * *

(e) Actuarial computations by the Internal Revenue Service. If the interest to be valued is dependent upon the continuation or termination of more than one life, or there is a term certain concurrent with one or more lives, or if the retained interest of the donor is conditioned upon survivorship, a special factor is necessary. The factor is to be computed upon the basis of the Makehamized mortality table appearing as Table 38 of United States Life Table and Actuarial Tables 1939-1941, published by the United States Department of Commerce, Bureau of the Census, and interest at the rate of 3-1/2 percent a year, compounded annually. Many such factors may be found in, or readily computed with the use of the tables contained in, a pamphlet entitled "Actuarial Values for Estate and Gift Tax." This pamphlet may be purchased from the Superintendent of Documents, United States Government Printing Office, Washington 25, D. C. However, if a special factor is required in the case of an actual gift, the Commissioner will furnish the factor to the donor upon request. The request must be accompanied by a statement of the date of birth of each person, the duration of whose life may affect the value of the interest, and by copies of the relevant instruments.

(f) The following tables shall be used in the application of the provisions of this section:

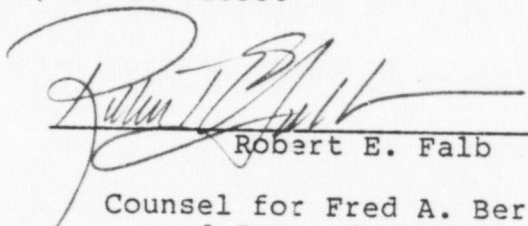
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CERTIFICATE OF SERVICE

It is hereby certified that service of this brief has been made on opposing counsel by mailing four copies thereof on this 17th day of November, 1975, in an envelope with postage prepaid, properly addressed to him as follows:

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